KORN FERRY

Perspectives

A REMEDY FOR HEALTHCARE BOARDS

As healthcare firms face one traumatic shift after another, an old-style way of picking and running boards is changing too. Korn Ferry looks at the makeovers of a few key examples.

The problem:

Some healthcare boards are still mired in an old-school approach to selecting board directors that prioritizes social connections over strategic thinking.

Why it matters:

Pressure from regulators, insurers, patients, and new competitors are changing how healthcare services are delivered and organizations are governed.

The solution:

Seek out a new class of directors who are more strategic and bottom-line focused to meet the organization's growth goals and transformation needs.

Its operations are enormous, consisting of five main campuses that are visited by more than 2 million people annually. Its workforce of roughly 12,000 employees makes it one of the largest private employers in Massachusetts. In total, it has more than $2 billion in assets. But this isn't a hot Boston tech company. Nor is it one of the 193 publicly traded companies based in Massachusetts. In fact, it's a nonprofit organization. The "it" in this case is Baystate Health.

Founded as a single hospital nearly 150 years ago, Baystate Health is one of the largest healthcare systems in the United States, a network comprised of a teaching hospital, a children's hospital, three community colleges, more than 80 medical practices, and, of course, an insurance provider. "We're trying to break away from the old hospital mindset and create a new kind of healthcare organization," says Mark Keroack, MD, president and CEO of Baystate Health. Part of the challenge, he concedes, is that doing so also creates a level of organizational complexity that's entirely new to healthcare industry leaders and boards.

Welcome to the new world of healthcare governance. The historical approach—where directors were appointed mostly based on social status or donation size—worked well when community-focused, standalone hospitals were the norm. But now they are the exception. Large regional and national healthcare systems have risen up in their stead. The ever-increasing complexity of healthcare services and regulations and the emergence of new competitors, which range from Apple to a joint venture between Amazon, JP Morgan Chase, and Berkshire Hathaway, are putting more pressure on boards than ever before.

"The dramatic changes in healthcare mean organizations need to be similarly dramatic in changing the types of directors who need to be on the board and how they go about finding them," says Tom Flannery, PhD, a senior client partner with Korn Ferry's Executive Pay and Governance practice who specializes in healthcare.

Healthcare organizations are trying to move away from traditional financial methods of donations and fundraising to a more for-profit, bottom-line focused orientation, while still adhering to the healing mission and support of sponsors. At the same time, the business model is transitioning from so-called fee-for-service to value-based care. Currently, offering healthcare is mostly built on volume; a doctor or hospital gets paid for treating patients regardless of results. Under value-based care, payment to doctors and revenue to hospitals are focused more on reducing causes of health issues and limiting chronic illnesses.

But that also means healthcare boards and leadership now have a new focus—generating new revenues streams—which requires a new breed of directors. "Healthcare organizations must quickly change the way they do business and become more flexible," Flannery says. "They must break away from the old hospital mindset."

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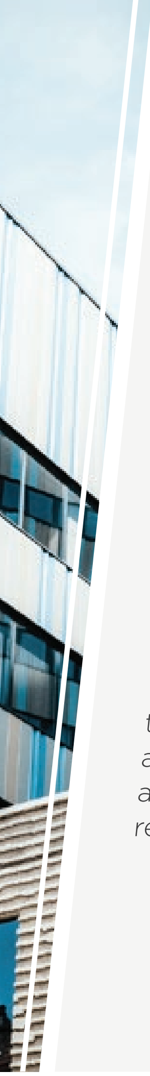
When organizations need topline growth, regardless of the industry, one of the first avenues leadership considers are mergers and acquisitions. Healthcare organizations, from global pharmaceutical giants to regional hospital chains, have never been immune to the siren call of bankers pitching deals. Except now the deals are larger, more frequent, and are reaching into every part of the patient journey.

Whether it was health insurer Cigna buying prescription management company Express Scripts, CVS Health merging with Aetna, or private equity firm KKR paying $9.5 billion for Envision Healthcare, healthcare deals came in all forms and sizes last year. In fact, healthcare organizations set an industry record for M&As in 2018, with about $421 billion in transactions, and the torrid pace is expected to continue this year.



Giant Moves ... Giant Change?

Large mergers and acquisitions are reshaping the healthcare industry.

Cigna – Express Scripts

Health insurance company Cigna paid $52 billion for Express Scripts, giving it entry into the prescription drug benefits business.

Amazon – JPMorgan Chase – Berkshire Hathaway

The venture between the tech, investment banking, and holding company giants aims to look at "how to redesign health insurance."

KKR – Envision Healthcare

KKR previously bought Envision's ambulance business. This nearly $10 billion deal added Envision's staffing firm for physicians, the largest in the nation. KKR plans to take the combined company private.

Apple Health Record

The deal between Apple and about 75 of the United States' largest hospitals aggregates patients' medical records via the iPhone's Health app, making it easier to access them during emergencies.

UnitedHealth Group – DaVita Medical Group

The nearly $5 billion acquisition makes UnitedHealth the largest single employer of doctors in the US.

According to Christine Rivers, PhD, a senior client partner in Korn Ferry's Board and CEO Services practice who specializes in healthcare, the board's role in evaluating, negotiating, and integrating acquisitions has never been more important. The board's responsibility with any potential deal is to weigh it against "the vision, mission, and direction the CEO wants to take the organization," says Rivers. "Will it create value and support the mission of the organization?" Far from a rubber stamp, that means asking tough questions about potential challenges, identifying "must-win" battles and how the deal helps win them, and uncovering its impact on financial stability.

The combination of Catholic health systems Bon Secours and Mercy Health—which created a 43-hospital firm across seven states and $8 billion in revenue—required this new kind of mindset for their boards. According to John M. Starcher Jr., president and CEO of the combined organization, within 30 days of the start of negotiations, the boards and leadership teams of both companies had developed a consolidated mission statement that outlined their core values and cultural competencies that would drive the ministry forward if a deal was reached.

As talks progressed, the boards put together a primary integration management team of executives from different areas of healthcare—physicians, marketing, finance, IT—to work on creating a new organizational structure, identify leadership candidates for the consolidated company, and draft retention plans for key talent. Starcher says the strategic planning allowed the

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new company to hit the ground running, with the CEO and 14 C-suite leaders installed in the first week following the deal's closing. Another 300 top leaders were in place throughout the company within the first 60 days.

"There's an art to evaluating whether someone who is successful in an isolated role will be successful in a consolidated role," says Starcher, explaining that most healthcare organizations operate with walled gardens separating clinical, operations, and other units, as opposed to the collaborative, frictionless environment needed today. "The trick is to not build a strategy around individuals but instead define a strategy and plug people with the right skills and behaviors into roles."

Sounds simple, but that's actually an all-too-common mistake that boards make. Every company has talented leaders. Not every company has talented leaders who have the right behaviors to create the culture an organization is trying to instill. Quite the contrary, talented leaders who don't have the right skills and behaviors, such as emotional intelligence, adaptability, and strategic thinking, could disrupt an entire organization's attempts to transform. In fact, a recent Korn Ferry study of 164 C-suite executives at 70 US-based hospitals and healthcare systems found a looming leadership crisis. Of those surveyed, 54% said their organizations did not have a suitable CEO replacement if something happened to their current one, and 43% said they don't have an effective succession plan in place.

"The industry has been tipped on its side," says Rivers, "and leadership planning hasn't necessarily kept up."

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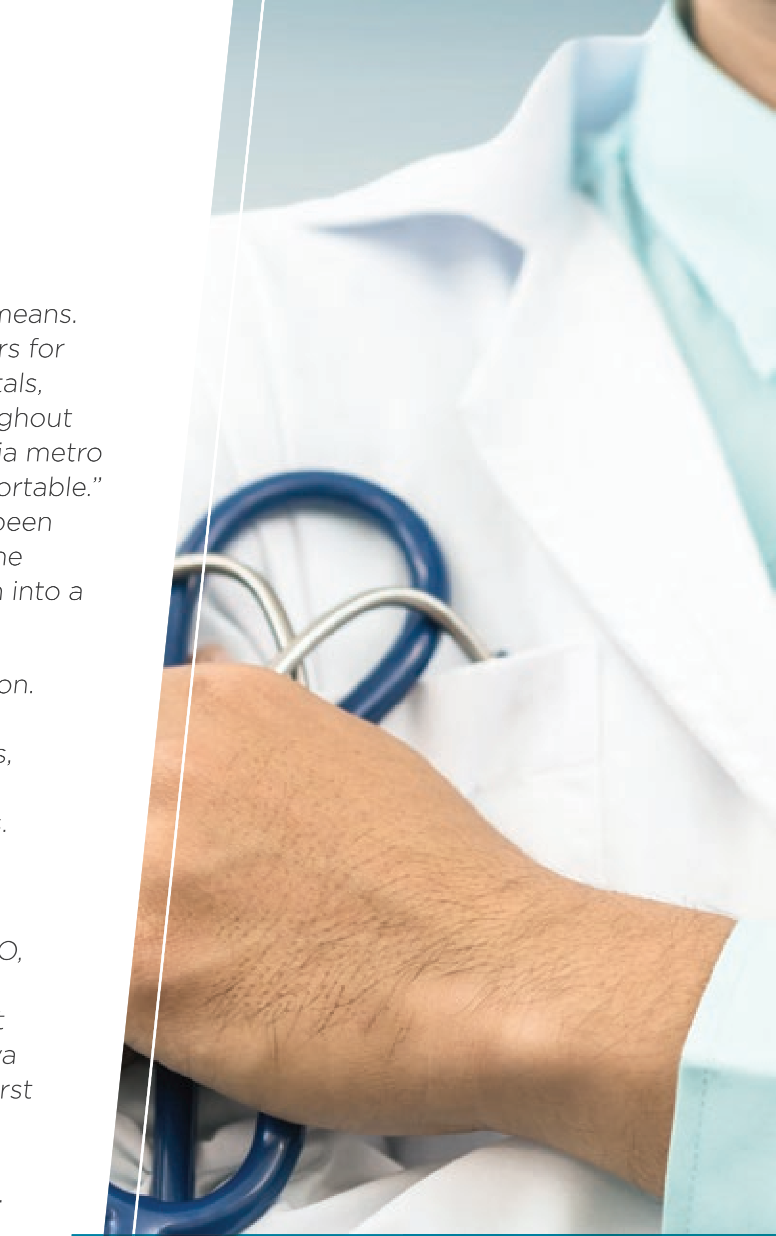
Tony Nader knows exactly what Rivers means. He readily admits that the board he chairs for Inova Health System, a network of hospitals, physicians, and other care facilities throughout the Washington, DC, and Northern Virginia metro area, had become "complacent and comfortable." It's understandable; the former CEO had been with Inova for 35 years and transformed the organization from a regional hospital chain into a national healthcare brand.

"We were not asking for the right information. We weren't doing enough digging into the strategy, relationships with external partners, or exploring new directions of where the organization should be heading," Nader says. "There wasn't a lot of communication and transparency amongst ourselves."

So when it came time to search for a new CEO, Nader used the opportunity to reanimate the board as well. He and the other directors went on a monthlong listening tour throughout Inova to do, as Nader says, some "self-examination first to find our blind spots." They talked to nurses, doctors, technicians, administrators, marketing staff, and others at all levels of the organization. From interviews with more than 100 people, the board put together a list of qualities the new CEO needed to have. "We didn't want to just replicate the former CEO," Nader says. "We wanted someone who could lead us through transformational change during this dynamic time in healthcare."

Ironically, however, the board eventually settled on a physician for the new CEO. He just happens to hold an MBA degree in addition to his MD. The combination of medical and business acumen is just what Inova needs as it builds out the strategy and facilities for the 117-acre campus it purchased from Exxon Mobil. "The new CEO and his team are in the process of evolving the plans," says Nader.



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A New Prescription

Healthcare organizations are rethinking their governing boards to meet the onslaught of industry change. Here are some key new skills and traits that leaders are looking for in potential directors.

Business acumen

Donations alone aren't going to cut it anymore. Directors need the ability to find new revenue streams.

Strategic thinking

With competitive pressure coming from all sides, healthcare organizations need directors who can anticipate change and drive the business forward.

Emotional intelligence

Healthcare organizations are unique community assets, and directors must have the empathy, influence, and other soft skills to balance the needs of the business with the needs of the community it serves.

Adaptability

Directors who are learning agile and embrace continuous training and development are in high demand given the industry's constant change.

M&A expertise

Deals aren't going away, so organizations are always on the hunt for directors with experience in this area, particularly involving vertical integrations or international deals.

Mission and drive

Directors who can blend the business goals of the organization with its higher purpose of caring for people are needed now more than ever.

Organizational design

As organizations become more complex, expertise in building leadership teams, creating new reporting structures, breaking down walls between business units, and other skills are in demand.

Culture and experience

Healthcare organizations have traditionally focused on clinical service over culture and experience. Changing talent and patient expectations, however, means they are in search of directors with expertise in internal engagement or customer journeys.

Beyond evaluating M&A deals or searching for a new CEO, healthcare boards are also being forced to confront challenges that never existed before—everything from artificial intelligence to data privacy. Meanwhile, they must also pay much more attention now to cultural movements, which can range from pay equity to environmental issues to impact investing to diversity and inclusion, and more.

This, of course, means that boards need to prospect for directors with entirely new skills and competencies than in the past. Korn Ferry's Flannery says rethinking a board's purpose for today's healthcare landscape means clearly articulating a mission and outlining key responsibilities, and then finding new directors with not only the skills, but also the values, temperament, agility, and leadership traits to fulfill that mission.

"Most healthcare boards are rethinking their membership profile by changing their mix to include more individuals with industry/business experience, or with specific expertise in areas such as technology, strategy, or governance," says Flannery. "[That's in addition to] attempting to identify soft skills that are necessary to be an effective, impactful board member."

Or, as Dr. Keroack of Baystate Health puts it, healthcare boards need to evolve to be more enterprise focused. That's easier said than done for organizations where creating a cohesive culture wasn't considered a top priority. "As the healthcare environment is disrupted by change at an ever-increasing pace, healthcare boards will require a fundamental re-examination and redesign to fulfill the changing requirements of their role," says Dr. Keroack. "It is essential that directors understand and align with the organizational culture of the system and its strategic direction."

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